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3000 Nonbanking Activities

The Bank Holding Company Act of 1956 was enacted to limit the expansion of banking institutions into nonbanking activities. A bank holding company was defined in the 1956 act as an entity that owned or controlled 25 percent or more of the voting shares of two or more banks; companies owning only one bank were exempted from regulation under the act.

During the 1960s there was a dramatic growth in the number of commercial enterprises that purchased one bank, engaged in nonbanking activities, and remained exempt from regulation. As a result of this change in the structure of bank ownership, Congress enacted the Bank Holding Company Act Amendments of 1970. Of these amendments, the most significant is the extension of the act to cover one-bank holding companies. The Federal Reserve Board was granted the authority to regulate the expansion of one-bank holding companies.

In 1978, Congress passed the International Banking Act. Section 8 of this act expanded the nonbanking prohibitions of the Bank Holding Company Act to foreign banks that engage in the business of banking in the United States directly through a branch or agency or indirectly through a subsidiary commercial lending company. This expanded the nonbanking restrictions beyond simply covering foreign banks that own or control U.S. banks or bank holding companies. However, section 2(h) of the BHC Act provides foreign organizations that are principally engaged in the business of banking outside the United States with exemptions from the nonbanking prohibitions of the BHC Act. Further exemptions have been granted by the Board's discretionary authority under section 4(c)(9) when such exemptions were in the public interest and were consistent with the purposes of the BHC Act.

Under section 4(c) of the BHC Act, Congress exempted a limited number of investments from the general prohibition against owning or controlling shares of nonbank concerns. Section 4(c)(8) permits investment in ''shares of any company the activities of which the Board after due notice and opportunity for hearing has determined by regulation to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.'' The act also provides that any bank holding company may apply to the Board for permission to engage in an activity that has not yet been determined to be permissible if the applicant is of the opinion that the activity in its particular circumstances is closely related to banking or managing or controlling banks. Section 225.25(b) of the Board's Regulation Y lists permissible nonbanking activities that the Board has deemed to meet these criteria (see appendix 1 of this section). The list of permissible nonbanking activities has been expanded at various times.

The Board has also permitted by order, on an individual basis, certain activities that it considers to be closely related to banking under section 4(c)(8) of the act, but in doing so the Board did not expand the list of permissible activities under section 225.25(b) of Regulation Y. For a list of such activities, see appendix 2 of this section.

In determining whether the performance of a nonbank activity by a bank holding company or the acquisition of a nonbank firm by a bank holding company is a proper incident to banking, the Board applies a ''public interest test.'' The Board determines whether the proposed new activity or proposed acquisition ''can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.''

An interpretation of Regulation Y (12 C.F.R. 225.126) dated April 28, 1972, and amended September 20, 1972, listed activities that the Board determined do not satisfy the ''so closely related'' test under section 4(c)(8). The Board subsequently determined that a number of other activities do not satisfy the closely related test. For a complete list of these impermissible activities, see appendix 3 of this section, and for a brief description of a selected number of the activities denied by the Board, see section 3700.0 et seq.

As the primary regulator for bank holding companies and their directly held nonbank subsidiaries, the Federal Reserve System conducts inspections of their operations, financial condition, and compliance with appropriate banking and other related statutes and regulations. Inspection personnel are called upon to evaluate the current condition of the organization as well as its future prospects.

On August 10, 1987, the Competitive Equality Banking Act of 1987 was signed into law. The act redefined the definition of ''bank'' in

section 2 of the BHC Act so that an FDIC-insured institution is deemed a bank.

State-authorized activities of savings banks. A special rule was established for qualified savings banks (state-chartered, FDIC-insured institutions organized before March 5, 1987) that are subject to the BHC Act (see section 2090.7). In accordance with section 3 of the BHC Act, a qualified savings bank may engage in any nonbanking activity, except insurance activities, either directly or through a subsidiary, that it is permitted to conduct directly as a state-chartered savings bank, even if those activities are not otherwise permissible for bank holding companies. In order to engage in those activities, however, a qualified savings bank must remain a savings bank, and a subsidiary of a savings bank holding company (a company that controls one or more qualified savings banks whose total aggregate assets, upon formation and at all times thereafter, constitute at least 70 percent of the assets of the holding company).

With respect to insurance activities, qualified savings banks may engage in underwriting and selling savings bank life insurance if the savings bank is located in Connecticut, Massachusetts, or New York and if certain other conditions are met.

BHCs engaging in nonbanking activities in foreign countries. A bank holding company has greater leeway to perform nonbanking activities abroad than in the United States in that it may engage in nonbanking activities abroad that would not be permissible in the United States. However, activities abroad are subject to limitations. Section 211.5 of Regulation K requires a bank holding company to limit its direct and indirect activities abroad to those usual in connection with banking and financial activities and to necessary related activities. Section 211.5 also lists particular activities that are permissible abroad and provides rules regarding when a bank holding company must submit an application to engage in such activities directly or through investments.

Edge Act or agreement corporations. A bank holding company may own an Edge or agreement corporation. The Federal Reserve Act and Regulation K govern the permissible activities of Edge or agreement corporations. An Edge or agreement corporation is an international banking vehicle that may only engage in listed or approved activities that are incidental to international or foreign business. The restriction generally permits an Edge or agreement corporation to only engage in international banking or financial activities (see 12 C.F.R. 211.4(e)). A separate manual, *Guidelines and Instructions for Examination of Edge Corporations*, sets forth the rules and procedures for examining Edge or agreement corporations and for determining whether their activities are permissible.

Companies that only own an Edge Act or agreement corporation. Any company, other than a bank, that acquired an Edge Act or agreement corporation after March 5, 1987, must conform its activities to section 4 of the BHC Act.

Underwriting and dealing in debt and equity securities. Beginning in January 1989, certain section 20 nonbanking subsidiaries of bank holding companies were approved to underwrite and deal in debt or equity securities (excluding open-end investment companies) (see 1989 FRB 192). The Board required, and delayed commencement of the activity, until it was determined by the Board that each applicant had established the necessary managerial and operational infrastructure to commence the expanded underwriting and dealing activity and to comply with their Board order. The applicant's capital plan had to be determined to be adequate along with the necessary policies and procedures needed to comply with the Board's order. The Board's order requires that loans to, and capital investments in, the underwriting subsidiary be deducted from the bank holding company's capital, as provided for in the Board's capital adequacy guidelines. The Board further confirmed that the activities could not be conducted in any other subsidiary other than the Board-approved section 20 subsidiary. (See section 3600.21.4.)

As for underwriting and dealing in equity securities, the Board stated in the order that it would review within a year whether the applicants could commence the activity. The first Board authorization to commence underwriting and dealing in equity securities was given on September 20, 1990, subject to the bank holding company's commitments within its respective Board order, including its commitment to maintain the capital of its section 20 subsidiary at levels necessary to support its activities and commensurate with industry standards, and that it will accordingly increase the capital of the section 20 subsidiary as it grows.

Modifications to the Board's orders authorizing BHC subsidiaries to underwrite and deal in bank-ineligible securities consistent with section 20 of the Glass-Steagall Act. The Board announced its approval of modifications to its previous section 20 authorizations by order, on

September 21, 1989 (1989 FRB 751). The modifications (1) raised from 5 percent to 10 percent (currently 25 percent) the revenue limit on the amount of total revenues a section 20 subsidiary may derive from bank-ineligible securities underwriting and dealing activities, and (2) permit the underwriting and dealing in securities of affiliates, consistent with section 20 of the Glass-Steagall Act, if the securities are rated by an unaffiliated, nationally recognized statistical rating organization, or are issued or guaranteed by the Federal National Mortgage Association (FannieMae), the Federal Home Loan Mortgage Corporation (FHLMC), or the Government National Mortgage Association (GNMA), or represent interests in such obligations.

Acting as agent in the private placement of all types of securities and acting as riskless principal in buying and selling securities. In another Board order, the Board authorized a bank holding company to transfer its private-placement activities from its commercial bank subsidiary to its section 20 subsidiary. The section 20 subsidiary would act as agent in the private placement of all types of securities, including the provision of related advisory services, and to buy all types of securities on the order of investors as a ''riskless principal.'' The Board concluded that the section 20 subsidiary's private placement of debt and equity securities within the limits proposed did not involve the underwriting or public sale of securities for the purposes of section 20 of the Glass-Steagall Act, and that the revenues derived therefrom should not be subject to the 25 percent revenue limitation placed on bank-ineligible securities activities. (See section 3230.4.)

Foreign banks authorized to operate section 20 subsidiaries to underwrite and deal in corporate debt, commercial paper, and other securities. In a Board order (1990 FRB 158), the Board authorized a foreign bank to operate a section 20 subsidiary under the bank to underwrite and deal in these securities (securities issued by open-end investment companies are not included). The foreign bank operated outside the United States but owned a subsidiary bank in the United States. To achieve equality between the domestic and foreign banking operations in the United States and in an effort to negate any advantages that a foreign bank might have over a domestic bank, the Board considered the foreign bank as a bank holding company even though the bank is not a subsidiary under a bank holding company structure. In so doing, the Board imposed restrictions on the section 20 subsidiary. The foreign bank may fund the section 20 subsidiary, but that action requires prior Board approval. In addition, the section 20 subsidiary may not borrow from its parent bank. Any loans to, transfers of assets to, or investments in the section 20 subsidiary must also have Board approval. See 1990 FRB 158, 455, 554, 568, 573, 652, and 683.

Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). This act became law on August 9, 1989. The law revised section 4(c)(8) of the BHC Act and authorized the Board to approve applications from bank holding companies for the acquisitions of savings associations. The Board thus revised section 225.25(b)(9) of Regulation Y to include as a permissible nonbanking activity the owning, controlling, or operating of a savings association, if the savings association engages only in deposit taking, lending, and other activities permissible for bank holding companies. The legislation required the Board to remove tandem restrictions of previous Board orders that are not prohibited by FIRREA and to confine, in approving applications, limitations on transactions between the savings association and its bank holding company affiliates to those required by sections 23A and 23B of the Federal Reserve Act. FIRREA made sections 23A and 23B applicable to savings associations as though they were member banks. Two exceptions apply: (1) no extensions of credit may be granted by a savings association to an affiliate unless it is engaged only in activities permissible for bank holding companies in the BHC Act, and (2) savings associations may not purchase or invest in securities of an affiliate other than shares of a subsidiary. The legislation also provided for a ''sister bank'' exemption from the provisions of sections 23A and 23B of the Federal Reserve Act. (See sections 2020.8 and 2090.8.1.)

1992 revisions to the Regulation Y (section 225.25(b)) list of nonbanking activities—the ''laundry list.'' During 1992, the Board initiated several actions that affected certain nonbanking activities. The first action, effective May 18, 1992, amended section 225.25(b)(5) of Regulation Y with regard to tangible personal property leases. Subject to the stated limitations, a bank holding company can rely on estimated residual values of up to 100 percent of the acquisition costs of the leased property in order to recover the bank holding company's leasing costs. Previously, the nonbanking activity had only been approved by Board order (see the initial Board order at 1990 FRB 462 and the subsequent

Board orders at 1990 FRB 960 and 1991 FRB 187 and 490).

The Board issued, effective August 10, 1992, a revised interpretive rule regarding investment advisory activities of bank holding companies to expressly provide that a bank holding company or its nonbank subsidiary may act as agent for customers in the brokerage of shares of an investment company advised by the holding company or any of its subsidiaries. In addition, the revision provides that a bank holding company or its nonbank subsidiary may provide investment advice to customers regarding the purchase or sale of shares of an investment company advised by an affiliate. In both instances the Board requires certain disclosures to be made to address potential conflicts of interest or adverse effects. See 12 C.F.R. 225.125(h), Regulation Y.

Two other subsequent Board actions further consolidated additional nonbanking activities into Regulation Y (sections 225.25(b)(4) and (b)(15)) that were previously approved by Board order, as they related to providing full brokerage services, and separately, financial advisory services. The Board approved both changes, subject to the limitations stated therein, effective September 10, 1992.

3000.0.1 CATEGORIES OF NONBANKING ACTIVITIES

Section 4(c)(8) of the BHC Act authorizes bank holding companies to engage directly or through a subsidiary in activities that the Board determines are closely related to banking or managing or controlling banks. The Board and the courts have established the following guidelines for determining whether a nonbanking activity is closely related to banking:[1]

1. whether banks have generally provided the service;

2. whether banks generally provide services that are operationally or functionally so similar to the proposed service as to equip them particularly well to provide the proposed service; or

3. whether banks generally provide services that are so integrally related to the proposed service as to require their provision in specialized form.

In addition, the Board may consider other factors in deciding what activities are closely related to banking.[2] Upon a positive determination that a proposed activity is ''closely related to banking or managing or controlling banks,'' the Board must also find that a proposed activity is a ''proper incident'' to banking and that performance of an activity by a bank holding company can reasonably be expected to produce benefits to the public (such as greater convenience, increased competition, or gains in efficiency) that outweigh possible adverse effects (such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices).

The following describes three categories of bank holding company nonbanking activities:

1. those that have been found to be permissible and are listed in Regulation Y, the so-called laundry list activities (see appendix 1);

2. those that are permissible by Board order only (see appendix 2); and

3. those that have been denied by the Board (see appendix 3).

1. *National Courier Association v. Board of Governors*, 516 F. 2d 1229 (D.C. Cir. 1975).

2. *Alabama Association of Insurance Agents v. Board of Governors*, 533 F.2d 224 (5th Cir. 1976), *cert. denied*, 435 U.S. 904 (1978).

3000.0.2 APPENDIX 1—ACTIVITIES APPROVED BY THE BOARD AS BEING CONSIDERED "CLOSELY RELATED TO BANKING" UNDER SECTION 4(c)(8) OF THE BANK HOLDING COMPANY ACT (SECTION 225.28(b) OF REGULATION Y)

Permitted by Regulation[1]	*Year Added to Regulation Y*
Note: The bulleted items in this appendix are provided for historical reference only. The narrative before the bulleted items reflects the current Regulation Y authorization.	
1. Extending credit and servicing loans	1971
Making, acquiring, brokering, or servicing loans or other extensions of credit (including factoring, issuing letters of credit, and accepting drafts) for the company's account or the account of others.	
2. Activities related to extending credit	
a. Appraising	
(1) Real estate appraising	1980
(2) Personal property appraising	1986
b. Arranging commercial real estate equity financing	1983
c. Check-guaranty services	1986
d. Collection agency services	1986
e. Credit bureau services	1986
f. Asset management, servicing, and collection activities	1997
g. Acquiring debt in default	1995
h. Real estate settlement servicing	1997
3. Leasing personal or real property or acting as agent, broker, or adviser in leasing such property	
• Personal property leasing[2]	1971
• Real property leasing	1974
4. Operating nonbank depository institutions	
a. Owning, controlling, or operating an industrial bank, Morris Plan bank, or industrial loan company so long as the institution is not a bank	1971
b. Owning, controlling, or operating a savings association, if the savings association engages in deposit-taking activities, lending, and other activities that are permissible for bank holding companies	1989
5. Trust company functions or activities	1971
6. Financial and investment advisory activities: acting as an investment adviser or financial adviser to any person, including (without limiting these activities in any way)—	1971

Permitted by Regulation[1]	*Year Added to Regulation Y*
a. Serving as an investment adviser to an investment company registered under the Investment Company Act of 1940, including sponsoring, organizing, and managing a closed-end investment company	1972
• Investment or financial advising	1971
• Advisory services to open-end (mutual fund) investment companies	1972
b. Furnishing general economic information and advice, general economic statistical forecasting services, and industry studies	1984
c. Providing advice in connection with mergers, acquisitions, divestitures, investments, joint ventures, leveraged buyouts, reorganizations, recapitalizations, capital structurings, financing transactions, and similar transactions,[3] and conducting financial feasibility studies[4]	1992
• Financial futures and options on futures	1986
d. Providing information, statistical forecasting, and advice with respect to any transaction in foreign exchange, swaps and similar transactions, commodities, and any forward contract, option, future, option on a future, and similar instruments	1992
• Financial futures and options on futures	1986
• Providing financial advice to—	
— state and local governments and	1973
— foreign governments, including foreign municipalities and agencies of foreign governments, such as with respect to the issuance of their securities	1992
• Inclusion of any investment or financial advisory activity without restriction	1997
• Discretionary investment advice to be provided to any person (includes investment advice regarding derivative transactions to institutional or retail customers as an investment, commodity trading, or other adviser) regarding contracts related to financial or nonfinancial assets (such advice is no longer restricted to institutional customers)	1997
• Financial and investment advice (or any permissible nonbanking activity) can be provided in any combination of permissible nonbanking activities listed in Regulation Y	1997
e. Providing educational courses and instructional materials to consumers on individual financial management matters	1986
f. Providing tax-planning and tax-preparation services	1986
7. Agency transactional services for customer investments (principal positions)	
a. Securities brokerage services (including securities clearing and/or securities execution services on an exchange) for the account of customers and does not include securities underwriting or dealing	
(1) Securities brokerage services (including securities clearing and/or securities execution services on an exchange), whether alone or	1982
(2) In combination with advisory services and incidental activities (including related securities credit activities and custodial services)	1992
b. Riskless-principal transactions	1997
c. Private-placement services	1997
d. Futures commission merchant activities	1984
• A nonbanking subsidiary may act as an FCM with respect to any exchange-traded futures contract and options on a futures contract based on a financial or nonfinancial commodity	1997

Permitted by Regulation[1]	*Year Added to Regulation Y*
e. Other transactional services such as providing to customers as agent transactional services with respect to the following:	1997
(1) Swaps and similar transactions	
(2) Investment transactions as principal[5]	
(3) Transactions permissible for a state member bank	
(4) Any other transaction involving a forward contract, an option, futures, an option on a futures or similar contract (whether traded on an exchange or not) relating to a commodity that is traded on an exchange	
8. Investment transactions as principal	
a. Underwriting and dealing in government obligations and money market instruments	1984
b. Investing and trading activities. Engaging as principal in the following:	
(1) Foreign exchange	1984
(2) Forward contracts, options, futures, options on futures, swaps, and similar contracts, based on any rate, price, financial asset (such as gold, silver, platinum, palladium, copper, or any other metal approved by the Board) or any other nonfinancial asset or group of assets, other than a bank-ineligible security	1997
(3) Forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on an index of a rate or price, or the value of any financial asset, nonfinancial asset, or group of assets, other than a bank-ineligible security, if the contract requires cash settlement	1997
9. Management consulting and counseling activities	
a. Providing management consulting advice on any matter (financial, economic, accounting, or audit) to any other company[6]	
• Unaffiliated banks (depository institutions)	1974
• Nonbank depository institutions	1982
• Other unaffiliated depository institutions	1997
• Any financial, economic, account, or audit matter to any other company	1997
b. Employee benefits consulting services	1997
c. Career counseling services	1997
10. Support services	
a. Courier services	1973
b. Printing and selling MICR-encoded checks and related documents	1997
11. Insurance agency and underwriting	
a. Credit insurance: acting as principal, agent, or broker for insurance (including home mortgage redemption insurance)	
• Acting as insurance agent or broker primarily in connection with credit extensions[7]	1971
• Underwriting credit life and credit accident and health insurance related to an extension of credit	1972

Permitted by Regulation[1]	*Year Added to Regulation Y*
b. Finance company subsidiary: insurance agent or broker for extension of credit by finance company subsidiary	1982
c. Insurance agency activities in small towns	1984
d. Insurance agency activities conducted on May 1, 1982	1984
e. Supervision of retail insurance agents	1984
f. Insurance agency activities by small bank holding companies	1984
g. Insurance agency activities conducted before 1971	1984
12. Community development	
a. Financing and investment in community development activities	1971
b. Advisory and related services designed to promote community welfare	1997
13. Issuance and sale of payment instruments	
a. Issuance and sale of retail money orders	1984
b. Sale of savings bonds	1979
c. Issuance and sale of traveler's checks	1981
14. Data processing	
a. Providing data processing and data transmission services; facilities (including data processing and data transmission hardware,[8] software, documentation, or operating personnel); databases; advice; and access to services, facilities, or databases by any technological means	
• Providing bookkeeping and data processing	1971
• Data processing and transmission services	1982
• Providing data processing and transmission advice to anyone on processing and transmitting banking, financial, and economic data	1997
b. Conducting data processing and data transmission activities not described in "a." that are *not* financial, banking, or economic[9]	1997

1. See section 225.28(b) of Regulation Y for the details of the regulatory authorizations.
2. The provision of higher residual value leasing for tangible personal property was added to Regulation Y in 1992, including acting as agent, broker, or adviser in leasing such property.
3. The words "and similar transactions" were added in 1997.
4. Feasibility studies do not include assisting management with the planning or marketing for a given project or providing general operational or management advice.
5. Transactions described in section 225.28(b)(8) of Regulation Y.
6. Management consulting services may be provided to other customers not described in section 225.28(b)(9) of the rule, but the revenues derived therefrom are subject to a 30 percent annual revenue limitation.
7. Scope narrowed to conform to court decisions in 1979 and 1981; in 1982, it was further narrowed by title VI of the Garn–St Germain Depository Institutions Act.
8. Beginning in April 1997, the general purpose hardware may not constitute more than 30 percent (previously 10 percent) of the cost of any package offering.
9. The total revenue may not exceed 30 percent of the company's total annual revenues derived from data processing and data transmission activities.

3000.0.3 Appendix 2—Activities Considered ''Closely Related to Banking'' under Section 4(c)(8) of the Bank Holding Company Act

Permitted by Order on an Individual Basis	*Year Approved*	*Manual Section 3600.*
1. Operating a ''pool-reserve plan'' for the pooling of loss reserves of banks with respect to loans to small businesses	1971	1
2. Operating an article XII New York investment company	1977	5.1
3. Underwriting and dealing in commercial paper to a limited extent	1987	21.1
4. Underwriting and dealing in, to a limited extent, municipal revenue bonds, mortgage-related securities, and commercial paper	1987	21.2
5. Underwriting and dealing in, to a limited extent, municipal revenue bonds, mortgage-related securities, consumer receivable–related securities, and commercial paper	1987	21.3
6. Issuing and selling mortgage-related securities backed by the guarantees of the Government National Mortgage Association	1988	23
7. Engaging in title insurance agency activities (approved under exemption G of the Garn–St Germain Depository Institutions Act of 1982)	1988	17.1
8. Underwriting and dealing in, to a limited extent, corporate debt and equity securities	1989	21.4
9. Acting as a sales-tax refund agent	1990	24.1
10. Providing real estate settlement activities through a permissible title insurance agency (exemption G companies only)	1990	26
11. Providing administrative and certain other services to mutual funds	1993	27
12. Acting as a dealer-manager in connection with cash-tender and exchange-offer transactions	1993	21.5
13. Privately placing limited partnership interests	1994	8
14. Engaging in real estate title abstracting	1995	30
15. Providing employment histories to third parties	1995	29
16. Underwriting ''private ownership'' industrial development bonds by a section 20 company	1995	21.6
17. Serving as a commodity pool operator of investment funds engaged in purchasing and selling futures and options on futures on certain financial and nonfinancial commodities	1996	13.1

Permitted by Order on an Individual Basis	*Year Approved*	*Manual Section 3600.*
18. Development of broader marketing plans and advertising, sales literature, and marketing materials for mutual funds (see 1997 FRB 678)	1997	28
19. Sale of government services involving (see 1998 FRB 481)—	1998	25
a. postage stamps and postage-paid envelopes b. public transportation tickets and tokens c. vehicle registration services (including the sale and distribution of license plates and license tags for motor vehicles) d. notary public services		
20. Operating a securities exchange	1999	6
21. Acting as a certification authority for digital signatures	1999	7

3000.0.4 Appendix 3—Activities Considered Not to Be "Closely Related to Banking" under Section 4(c)(8) of the Bank Holding Company Act

Activities Denied by the Board	*Year Denied*
1. Insurance premium funding ("equity funding") (combined sales of mutual funds and insurance)	1971
2. Underwriting general life insurance not related to credit extension	1971
3. Real estate brokerage	1972
4. Land investment and development	1972
5. Real estate syndication	1972
6. General management consulting	1972
7. Property management	1972
8. Trading in platinum and palladium coin and bullion[1]	1973
9. Armored car service[2]	1973
10. Sale of level term credit life insurance	1974
11. Underwriting mortgage guarantee insurance	1974
12. Computer output microfilm services[3]	1975
13. Operating a travel agency	1976
14. Underwriting property and casualty insurance	1978
15. Real estate advisory activities	1980
16. Certain contract key entry services	1980
17. Offering investment notes with transactional features	1982
18. Engaging in "pit arbitrage" spread transactions on commodities exchanges to generate trading profits	1982
19. Engaging in the publication and sale of personnel tests and related materials	1984
20. Providing credit ratings on bonds, preferred stock, and commercial paper	1984
21. Providing independent expert actuarial opinions of a general nature for purposes such as divorce action and personal injury litigation	1984
22. Acting as a specialist in foreign-currency options on a securities exchange	1985

Activities Denied by the Board	*Year Denied*
23. Title insurance activities (See the Board letter dated March 17, 1986, re: Independence Bancorp, Inc. and the Board order at 1989 FRB 31)	
24. Acting as a broker for customers in the purchase and sale of forward contracts based on certain financial and nonfinancial commodities, and acting as the primary clearing firm for professional floor traders[4]	1991

1. Authorized by the Board in 1995 FRB 190 (platinum) and 1996 FRB 571 (palladium).

2. On June 18, 1990, the Board determined that the activity of providing armored car services to the general public is closely related to banking (see 1990 FRB 676). In order for the Board to approve a nonbank activity for a bank holding company, the Board must also find that the activity is a "proper incident thereto." On February 10, 1993, the Board denied the application (1993 FRB 352), finding that the proposed transactions posed potential violations of section 23B of the Federal Reserve Act and that the applicant had failed to prove that the activity is a proper incident to banking.

3. The Board's interpretation of Regulation Y at 12 C.F.R. 225.123 was amended on November 25, 1987, by deleting item (e)(4) relating to the impermissibility of the activity (see 52 *Federal Register* 45160–45161 and 1987 FRB 933).

4. The Board subsequently approved this activity by Board order. (See 1997 FRB 138.)

As an FDIC insured institution, a savings bank qualifies as a ''bank'' under section 2(c) of the BHC Act, as amended by section 101(a) of the Competitive Equality Banking Act of 1987 (''CEBA''). CEBA amended the BHC Act, in section 3(f), stating that any qualified savings bank, which is a subsidiary of a bank holding company, could engage directly, or through a subsidiary, in any nonbanking activity, except for certain insurance activities, that it is permitted to engage in by State law—including activities which are not otherwise permitted for bank holding companies under section 4(c)(8) of the BHC Act. In order for a qualified savings bank, that is a subsidiary of a bank holding company, to engage in such activities, however, the bank holding company must be a savings bank holding company as defined in section 2(l) of the BHC Act, in other words, 70 percent of the assets of the bank holding company must consist of one or more savings banks at the time of formation.

Insurance activities of any qualified savings bank which is a subsidiary of a bank holding company are limited to the insurance activities allowed under section 4(c)(8) of the BHC Act. A qualified savings bank that was authorized to engage in the sale or underwriting of savings bank life insurance, as of March 5, 1987, can sell or underwrite such insurance directly, provided that it is permitted to underwrite and engage in the sale of savings bank life insurance as that activity is authorized for savings banks by state law, and is located in Massachusetts, Connecticut, or New York. Should the bank holding company parent of the qualified savings bank cease to be a savings bank holding company, the savings bank must cease engaging in these activities within two years.

In a separate application a nonoperating company, which was formed for the purpose of acquiring a savings bank, insured by the Federal Deposit Insurance Corporation, applied for the Board's approval to become a bank holding company pursuant to section 3(a)(1) of the Bank Holding Company Act, acquiring all of the voting shares of the savings bank. The savings bank engages through subsidiaries in real estate investment and development activities authorized pursuant to State law.

As part of the Board's analysis in this case, including its evaluation of the capital and financial resources of the bank holding company and the bank involved, the Board considered the risk to the Applicant and to the savings bank of the real estate development activities to be conducted by the savings bank through its nonbank subsidiaries. The Board expressed serious reservations with regard to this application and similar applications by bank holding companies to acquire savings banks engaged directly or through subsidiaries in real estate development activities. In the Board's view the conduct of real estate development activities through a holding company subsidiary rather than a bank subsidiary would provide more effective corporate separateness.

The Board approved the application by Order on October 30, 1987 (1987 FRB 925), relying on the Applicant's commitments.

3010.0.1 INTRODUCTION

The prohibitions against a bank holding company having or acquiring nonbank interests do not apply to bank holding companies meeting the requirements of section 4(c)(i) and (ii) of the Act.

3010.0.2 LABOR, AGRICULTURAL OR HORTICULTURAL ORGANIZATIONS

Section 4(c)(i)—"Any company that was on January 4, 1977, both a bank holding company and a labor, agricultural or horticultural organization exempt from taxation under section 501 of the Internal Revenue Code of 1954, or . . . any labor, agricultural or horticultural organization to which all or substantially all of the assets of such company are hereafter transferred."

Exemption under this section was amended when the Financial Institutions Regulatory and Interest Rate Control Act of 1978 became effective early in 1979. The effect of the amendment was to repeal exemption under this section for labor, agricultural or horticultural organizations becoming BHCs after *January 4, 1977*, except for those organizations becoming BHCs by means of acquiring all or substantially all of the assets of a company that was both a BHC and a labor, agricultural or horticultural oganization exempt from taxation on January 4, 1977. In order for a holding company to be entitled to this exemption, net income derived from the organization cannot inure to the benefit of any individual. Organizations must be formed primarily for the betterment of the working conditions of the labor organization's members, or improvement in the grade of agricultural or horticultural products for an agricultural or horticultural organization. The growing of products for profit by agricultural or horticultural organizations would disqualify them for exemption. Thus the phrase "any labor, agricultural or horticultural organization" is intended to include only such organizations that are also exempt from taxation under section 501 of the Internal Revenue Code of 1954.

In order for a labor, agricultural or horticultural organization to receive exemption from taxation under section 501(c)(5) of the Internal Revenue Code of 1954, it must file an application (form 1024) with the IRS. In response to the application, the organization receives a determination letter which should be reviewed to assure that exemption was allowed and to verify the date the company became exempt under section 501. The date of exemption is determined as follows. A company which files for exemption within 18 months after its organization is considered exempt as of the date of its organization. The date of IRS approval is the date of exemption if application for exemption is filed more than 18 months after organization. The date of exemption must be no later than January 4, 1977, for the company to be entitled to exemption from section 4 of the Act. The fact that an organization pays income taxes annually does not disallow its exemption under section 501 of the tax code. Despite its tax exemption, an organization is subject to tax on its unrelated business income.

3010.0.3 FAMILY-OWNED COMPANIES

Section 4(c)(ii)—"A company covered in 1970 more than 85 percentum of the voting stock of which was collectively owned on June 30, 1968, and continuously thereafter, directly or indirectly, by or for members of the same family, or their spouses, who are lineal descendants of common ancestors."

The phrase "voting stock" does not limit the form of an organization to an incorporated entity. Exemption under this section extends to other forms of business associations which meet the definition of a company. For example, for a partnership, the 85 percent rule applies to "general partnership interest" and for a trust which meets the definition of a company, the 85 percent rule applies to "beneficial ownership." A company must continue to control the same subsidiary bank that it controlled on June 30, 1968, to retain its exemption under this section. Lineal descendants of common ancestors include descendants by half as well as full blood and legally adopted children.

In January 1980, the Board approved an application of a one-bank holding company covered by the exemption in 4(c)(ii) to acquire an additional bank, but stated that the holding company could no longer rely on that section for conducting its nonbanking activities. Based upon its review of the legislative intent of Congress in providing this exemption, it was the Board's judgment that the exceptionally broad exemp-

tion afforded by section 4(c)(ii) must be limited to family-owned one-bank holding companies that are not engaged in the management of banks. Moreover, in the Board's view, upon the acquisition of an additional bank, a one-bank holding company that is exempt under section 4(c)(ii) of the Act, would become engaged in the management of banks, and would thereby terminate its eligibility for the exemption. In addition, the Board believed that to permit unsupervised nonbank expansion by a multibank holding company would constitute an evasion of the Act, which the Board is authorized to prevent pursuant to section 5(b) of the Act.

3010.0.4 INSPECTION OBJECTIVES

1. To verify that a holding company qualifies for exemption from the prohibitions of section 4 by virtue of either section 4(c)(i) or 4(c)(ii).

2. Review the activities conducted by a company qualifying for an exemption under section 4(c)(ii) of the BHC Act, which may be faced with revocation of the exemption, and determine if there may be eligibility for permanent grandfathering under section 4(a)(2) of the BHC Act.

3010.0.5 INSPECTION PROCEDURES

1. Although bank holding companies qualifying for a section 4(c)(i) or 4(c)(ii) exemption are not routinely inspected on a periodic basis, when inspected their exempt status should be verified. All nonbank activities of exempt organizations should be examined in the inspection. The nature of all such activities and the dates they were commenced should be documented in the work papers to establish their current permissibility in the event the organization should lose its exemption from section 4.

2. For BHCs exempt under section 4(c)(i), the examiner should ascertain the date the company became exempt under section 501 of the tax code. Also, the stock books of the subsidiary bank or other pertinent documents should be reviewed to assure that the company was a BHC on January 4, 1977.

3. When verifying a company's exemption under section 4(c)(ii), the stock records of the subsidiary bank and the stock records, partnership agreements, trust agreements and other records of the bank holding company should be reviewed to assure that the following conditions have been satisfied:

a. 25 percent or more of the voting stock of the subsidiary bank has been continuously owned by the BHC since June 30, 1968;

b. Members of the same family have continuously held an 85 percent or more interest in the holding company since June 30, 1968.

3010.0.6 LAWS, REGULATIONS, INTERPRETATIONS, AND ORDERS

Subject	*Laws* [1]	*Regulations* [2]	*Interpretations* [3]	*Orders*
Acquisition of an additional bank by a company exempt under 4(c)(ii)				1980 FRB 165
"Successor" to a Company Exempt under 4(c)(ii)				1980 FRB 349

1. 12 U.S.C., unless specifically stated otherwise.
2. 12 C.F.R., unless specifically stated otherwise.
3. Federal Reserve Regulatory Service reference.

3020.0.1 INTRODUCTION

By virtue of section 4(c)(1) of the Act, a bank holding company may invest, without supervisory approval, in the shares of companies engaged in activities that Congress felt were incidental to the business of banking. The following activities are permissible investments for bank holding companies under this section.

3020.0.2 PROVIDING BANKING QUARTERS

Section 4(c)(1)(A) provides that a BHC may invest in a company engaged in holding or operating properties used wholly or substantially by any banking subsidiary of such bank holding company in the operations of such banking subsidiary or acquired for such future use.

Normally, bank utilization of 50 percent or more of the property would meet the requirements of this section. Investments in property where usage of such property by subsidiary banks is less than 50 percent will be reviewed on an *ad hoc* basis to determine its permissibility under this section. Future needs of the bank holding company and its bank subsidiaries will be considered when reviewing these cases.

In acquiring property, a bank holding company must have definite plans for use of the property as a subsidiary bank's premises within a reasonable period of time. Property may not be acquired and indefinitely warehoused until a need develops for the property.

This section of the BHC Act does not provide the authority for a BHC to invest in the shares of a company engaged in holding or operating properties used by nonbank subsidiaries. Directly holding or operating properties used by a nonbank subsidiary is considered an incidental activity necessary to carry on the main business activity of the subsidiary and thus is exempt under section 4(a)(2)(A) of the Act and section 225.22(a)(2)(vi) of Regulation Y.

3020.0.3 SAFE DEPOSIT BUSINESS

Section 4(c)(1)(B) of the Act provides that a holding company may invest in the shares of a company whose activities are limited to conducting a safe deposit business. Refer to Section 225.22(b) of Regulation Y.

3020.0.4 FURNISHING SERVICES TO BANKING SUBSIDIARIES

Section 4(c)(1)(C) of the BHC Act provides that a BHC may invest in a company which furnishes services to or performs services for the bank holding company or its banking subsidiaries. Section 225.22(a) of Regulation Y provides that a bank holding company may, without the Board's prior approval, furnish services to or perform services for its banking and nonbanking subsidiaries either directly or indirectly through a subsidiary. Generally, a BHC may only provide services related to the internal operations of the BHC or its subsidiaries. A bank holding company or its subsidiaries may not rely on the servicing exemption to deal with the public as principal, but may deal with outside parties provided they are acting only as agent for the holding company or its subsidiaries.

The term ''services'' implies servicing operations a bank may carry on itself, but which the BHC chooses to have done through a nonbank subsidiary. Section 225.22(a)(2) states that services for the internal operations of the bank holding company or its subsidiaries include: accounting, auditing, appraising, advertising, public relations, data processing, data transmission services, data bases or facilities, personnel services, courier services, holding or operating property used wholly or substantially by a subsidiary in its operations or for its future use, and selling, purchasing or underwriting insurance such as blanket bond insurance, group insurance for employees, and property and casualty insurance. For the later insurance activities, bank holding companies are permitted under the servicing exemption to act as agent or to underwrite insurance on their own risks (e.g. blanket bond insurance or employee group insurance plans). Refer to section 225.22(a)(2) of Regulation Y for other services permissible for the internal operations of the BHC or its subsidiaries.

The servicing exemption extends to services that are normally performed by a bank for its customers or correspondent banks. These activities generally include computerized billing, payroll, accounting, financial records maintenance and other similar data processing services as long as the subsidiary bank is permitted under applicable State or federal law to provide the service. These services may be provided only

upon request by the customers to the subsidiary bank. Furthermore, the contractual arrangements must be made between the customer and the bank. The company can service existing service contracts the bank has originated but is prohibited from purchasing the contracts or entering into contracts to provide services directly to the public.

The purchasing of participations by the parent in loans from subsidiary banks generally is not considered an exempt activity under the authority of sections 4(a)(2) or 4(c)(1). Holding companies that engage in the purchase of participations from their subsidiary banks should file an application pursuant to Section 4(c)(8) of the BHC Act. Purchasing participations in loans for the purpose of providing liquidity or acquiring a portion of a line of credit to facilitate the needs of the bank's customers (overlines) provides a service or benefit to the bank and is considered an acceptable purchase under the services exemption. In all cases where a participation in a loan is purchased, the loan must be made in the name of the bank and serviced by the respective bank. The purchasing of a loan for reasons other than those set forth above may be viewed as a direct lending activity.

3020.0.5 FURNISHING SERVICES TO NONBANK SUBSIDIARIES

The Bank Holding Company Act of 1956 prohibited a BHC itself from engaging in any business except (1) banking, (2) managing or controlling banks, and (3) furnishing services to its bank subsidiaries. In 1970, Congress amended section 4 of the BHC Act to expressly authorize a BHC to furnish services to or perform services for its nonbank subsidiaries as well as its bank subsidiaries under exemption A of section 4(a)(2). While section 4(c)(1) authorizes a BHC to invest in shares of a company engaged in certain activities, exemption A provides the authority for a BHC to engage in those activities directly.

The Board issued an interpretation (12 C.F.R. 225.141), effective August 1980, which stated that it will permit, without any regulatory approval, a bank holding company to form a wholly-owned subsidiary to perform servicing activities for both banking and nonbanking subsidiaries that the holding company itself could perform directly or through a department or a division under section 4(a)(2)(A) of the BHC Act. In addition, an approved section 4(c)(8) company may form a wholly-owned subsidiary to engage in activities that such company could itself engage in.

3020.0.6 LIQUIDATING ASSETS

Section 4(c)(1)(D) provides that a BHC may own shares of a company which engages in liquidating assets acquired from such BHC (not including its nonbank subsidiaries) or its banking subsidiaries or which were acquired from any other source prior to May 9, 1956, or the date on which such company became a BHC, whichever is later.

Assets acquired for liquidation by a section 4(c)(1)(D) subsidiary are subject to the same time limitations as shares acquired D.P.C. pursuant to section 4(c)(2) of the Act.

BHCs seeking to hold the shares of a liquidating or nominee subsidiary organized to dispose of assets acquired D.P.C. by a BHC nonbank subsidiary, can rely on the Board's August 1980 interpretation permitting, without prior regulatory approval, a BHC to form a subsidiary to perform activities which itself could perform under exemption A of section 4(a)(2).

3020.0.7 INSPECTION OBJECTIVES

1. To determine whether the activities conducted by companies in which the BHC has a greater than 5 percent investment in the company and for which the BHC claims exemption under section 4(c)(1) of the BHC Act, are the types of permissible activities contemplated by that section—activities claimed under the premises exemption under 4(c)(1)(A), the safe deposit business exemption under 4(c)(1)(B), the services exemption under (4)(c)(1)(C), or the liquidating subsidiary exemption (4)(c)(1)(D).

3020.0.8 INSPECTION PROCEDURES

The inspection of a nonbank subsidiary exempt under section 4(c)(1) of the Act should center on a review of the activities to assure that those activities are the types permissible under section 4(c)(1) subsections A, B, C and D.

3020.0.8.1 Section 4(c)(1)(A)—Bank Premises

The following procedural steps should be performed in connection with an inspection of a bank premises company.

1. Obtain a list of all real estate held by the company including the following information:

a. Property description and location;

b. Date acquired;

c. Current utilization;

d. Extent of utilization by banking subsidiaries and others indicating percentage of square feet leased to subsidiaries.

2. When use of the property by a subsidiary bank(s) is less than 50 percent, discuss future plans for the use of the property with management. Note any related discussion contained in the minutes of directors' and committee meetings, and action taken to date to implement these plans. Lease agreements with other tenants should be reviewed to determine the term of a lease including options to renew.

3. Evaluate the permissibility of holding each property under the premises exemption.

4. Review and evaluate other activities engaged in and assets held by the company to establish their permissibility under the premises exemption. Such activities could include leasing property and providing a general maintenance service to other tenants.

3020.0.8.2 Section 4(c)(1)(B)—Safe Deposit Business

Activities exempt under this section are restricted to conducting a safe deposit business. All activities engaged in and assets held by companies for which the BHC is claiming exemption under this section should be reviewed and evaluated to determine their permissibility under this exception.

3020.0.8.3 Section 4(c)(1)(C)—Services

The following procedural steps should be performed when inspecting service companies.

1. List and describe all services provided to subsidiaries in the inspection report.

2. Review and evaluate the types of services provided to the banking and nonbanking subsidiaries to determine their permissibility.

3. Obtain from management any written bank holding company policies concerning the provision of services and the assessment of fees or discuss with management the basis on which service fees are established.

4. Comment on the reasonableness of fees relative to the fair market value, cost, volume, or quality of such services rendered.

5. Indicate if all service contracts have been approved by each subsidiary's board of directors.

6. When reviewing services provided to banking subsidiaries for their customers:

a. List and describe all services provided;

b. Determine that the company is operating as an adjunct to its affiliated banks for the purpose of facilitating the bank's operations, and not as a separate, self-contained organization;

c. Review contractual arrangements to assure that the company has not purchased any service contracts from a subsidiary bank and has not entered directly into agreements to provide services to any party other than the bank;

d. Review and evaluate all services to determine whether they are services that the subsidiary bank is permitted to provide under applicable State or federal law.

3020.0.8.4 Section 4(c)(1)(D)—Liquidating Subsidiary

The following procedural steps should be followed in connection with an inspection of a liquidation company in which the BHC holds an investment.

1. Obtain a list of all assets acquired by the company for the purpose of liquidation including the following information:

a. Asset description and location;

b. Date acquired;

c. Source of acquisition;

d. Liquidation plans, including timetable and selling price;

e. Cost of assets and book value, including detail on any improvements.

2. Verify that assets acquired from sources other than the parent or its subsidiary banks were acquired prior to May 9, 1956, or the date on which the holding company became a BHC, whichever is later.

3. Verify that assets acquired for liquidation did not originate in a nonbank subsidiary. If a section 4(c)(1)(D) liquidating subsidiary is holding a material amount of assets acquired from a nonbank subsidiary, discuss the propriety of these holdings with the Reserve Bank office staff and, if necessary, Board staff in the Division of Banking Supervision and Regulation or the Legal Division.

4. Review the bank holding company's policies, practices and procedures concerning the liquidation of assets and determine if the subsidiary is in compliance with the time limits indicated above.

5. Discuss with management and note the

liquidation plans and progress to date in liquidating assets that have been held in excess of 12 months. Note any related discussion found in the minutes of directors' and committee meetings.

6. Comment on whether management is making a *bona fide* effort to dispose of all assets for fair value.

7. Check improvements made to property by the company to assure that the nature and use of the asset has not substantially changed. The investment of funds to change substantially the nature of the asset (such as undeveloped real estate) to increase its value would generally be viewed as engaging in real estate development, an activity which is not permissible.

3020.0.9 LAWS, REGULATIONS, INTERPRETATIONS, AND ORDERS

Subject	*Laws* [1]	*Regulations* [2]	*Interpretations* [3]	*Orders*
Purchase of instalment paper for subsidiary banks as furnishing of services		225.104	4–192	
Furnishing insurance not ''services''		225.109	4–193	
Services for banks that are not subsidiaries		225.113	4–194	
Computer services for customers of subsidiary banks		225.118	4–195	
Applicability of Bank Service Corp. Act in certain BHC situations		225.115	4–174.1	
Mortgage company services		225.122	4–196	
Insurance and sale of short-term debt obligations by BHCs		250.221, 225.130	4–867	
Operations subsidiaries of a BHC		225.141		
Shares held by a subsidiary bank in a bank premises company and the applicability of section 4(c)(1)(A)		225.101(g) 225.141	4–185	
Investment in an asset liquidation subsidiary	1843(c)(1)(D)			
Providing services to bank and nonbank subsidiaries	1843(a)(2)(A)	225.22(a)		
BHC dealing for a BHC's own account in futures, and options on futures, on gold and silver bullion to limit price risks in trading				1987 FRB 61
BHC subsidiaries performing services that BHC could itself perform				1980 FRB 774

Subject	*Laws* [1]	*Regulations* [2]	*Interpretations* [3]	*Orders*
Approved 4(c)(8) subsidiary forming an operations subsidiary to perform activities it could itself perform				1979 FRB 566 footnote 1

1. 12 U.S.C., unless specifically stated otherwise.
2. 12 C.F.R., unless specifically stated otherwise.
3. Federal Reserve Regulatory Service reference.

Section 4(c)(2) of the Bank Holding Company Act permits a bank holding company or any of its subsidiaries to acquire shares in satisfaction of debts previously contracted (DPC) in good faith. The shares must be disposed of within two years from the date they were acquired, except that the Board is authorized upon application of a company to grant additional exemptions if, in its judgment, the extension would not be detrimental to the public interest and either the bank holding company has made a good faith attempt to dispose of those shares during the five-year period, or the disposal of the shares would have been detrimental to the company. The aggregate duration of the extensions cannot extend beyond 10 years.

Even though the statute refers specifically to shares, the Board has taken the position, in section 225.22(d) of its Regulation Y and in an interpretation (12 C.F.R. 225.140), that the congressional policy evidenced by section 4(c)(2) should apply to DPC acquisitions of other assets, other than shares (assets), and real estate by bank holding companies and their nonbanking subsidiaries. Section 225.22(d)(1) provides the same holding periods (including provision for extensions) for other DPC assets or real estate as are provided by statute for DPC shares.

Regulation Y, section 225.22(d), addresses nonbanking acquisitions that do not require prior Board approval. With respect to DPC acquisitions, voting securities, or other assets or real estate acquired by foreclosure or otherwise, in the ordinary course of collection of a debt previously contracted (DPC property) in good faith, Regulation Y does not require the Board's prior approval if the DPC property is divested within two years of acquisition. Regulation Y further states that the Board may, upon request, extend the two-year period for up to three additional years. Further, the Board may permit additional extensions for up to five years (for a total of 10 years). This provision applies to shares, real estate, or other assets in which the holding company demonstrates that each extension would not be detrimental to the public interest and either the bank holding company has made good faith attempts to dispose of such shares, real estate, or other assets, or the disposal of the shares, real estate, or others assets during the initial period would have been detrimental to the company. Transfers within the bank holding company system do not extend any period for divestiture of the property.

Under the Board's delegated authority, the Reserve Banks may approve a BHC's requests for extensions beyond the two-year divestiture period.[1] In accordance with a Board interpretation (12 C.F.R. 225.138), extensions should not be granted except under compelling circumstances, and periodic progress reports on divestiture plans are generally required. When these permissible extension periods expire, the Board no longer has discretion to grant further extensions. A BHC would be in violation of the act if shares, other assets, or real estate acquired DPC is not disposed of within the prescribed time frame.

In July 1980, the Board issued an interpretation of Regulation Y (12 C.F.R. 225.140) that provided for a possible approval for an additional five-year period for the divestiture of real estate acquired DPC. With respect to DPC real estate, this interpretation requires that (1) the value of the real estate on the books of the company be written down to fair market value, (2) the carrying costs cannot be significant in relation to the overall financial position of the company, and (3) the company must make good faith efforts to effect divestiture. Fair market value should be derived from appraisals, comparable sales, or some other reasonable method. Companies holding real estate for this extended period are expected to make active efforts to dispose of it, and they should advise the Reserve Bank regularly concerning their ongoing efforts.

In accordance with the Board's interpretation (12 C.F.R. 225.140), after two years from the date of acquisition of DPC assets, the holding company is to report annually to the Federal Reserve on its efforts to accomplish divestiture of the assets. The Reserve Bank will monitor the efforts of the company to effect an orderly divestiture. Divestiture may be ordered before the end of the authorized holding period (beyond the initial two-year period that requires no Board authorization) if supervisory concerns warrant such action.

Section 4(c)(1)(D) allows a bank holding company to establish a subsidiary to hold real estate acquired by itself or by any of its banking subsidiaries for debts previously contracted, for the purpose of disposing of the real estate in an orderly manner. Permissible activities of this

1. Each Federal Reserve Bank has been delegated the authority (12 C.F.R. 265.2(f)(12)) to extend the time within which a bank holding company or any of its subsidiaries must divest itself of interests acquired in satisfaction of a debt previously contracted.

liquidating subsidiary include completion of a real estate development project and other activities necessary to make the real estate saleable. The ''date of acquisition'' is the date the bank holding company (or subsidiary of the bank holding company) acquired the DPC asset. Section 4(c)(1)(D) may not be used to extend the time under which a bank holding company may indirectly hold DPC property under section 4(c)(2). In most cases where a subsidiary bank has held property for the statutory holding period, a BHC may not shift the property to another subsidiary or to the parent to avoid disposing of the property. However, due to the complexity and potential impact on the organization of a forced divestment at the end of the holding period, inspection personnel and Reserve Bank staff are encouraged to discuss the situation with Board staff to tailor the supervisory response to the particular situation.

With respect to the transfer by a subsidiary of other DPC shares, other assets, or real estate to another company in the holding company system, including a section 4(c)(1)(D) liquidating subsidiary, or to the holding company itself, such transfers would not alter the original divestiture period applicable to such shares or assets at the time of their acquisition. Moreover, to ensure that assets are not carried at inflated values for extended periods of time, the Board expects, in the case of all such intercompany transfers, that the shares or assets will be transferred at a value no greater than the fair market value at the time of transfer and that the transfer will be made in a normal arm's-length transaction. With regard to DPC assets (except for DPC shares as described above) acquired by a banking subsidiary of a holding company, as long as the assets continue to be held by the bank itself, the Board will regard them as being solely within the authority of the primary supervisor of the bank.

Section 4(c)(3) of the Bank Holding Company Act permits a bank holding company to acquire shares or real estate from any of its subsidiaries if a subsidiary had been requested to dispose of the shares by any federal or state authority having power to examine the respective subsidiary. The Board does not have authority to extend the two-year disposition period under section 4(c)(3) of the act. Section 4(c)(3) may not be used to extend the statutory period in which a bank must dispose of DPC assets (10 years in the case of DPC real estate assets, five years for all other).

3030.0.1 EXEMPTION TO SECTION 4(c)(2) DISPOSITION REQUIREMENTS OF DPC SHARES

Section 4(c)(5) of the Bank Holding Company Act allows a bank to own shares in certain nonbanking companies, specifically, the kinds and amounts eligible for investment by national banking associations under the provisions of section 5136 of the Revised Statutes (see section 3050.0 for a detailed explanation of section 4(c)(5)). The exemption provided by section 4(c)(5) covers any shares, including shares acquired DPC, that meet the conditions set forth in that exemption. Therefore, DPC shares held by a banking subsidiary of a bank holding company which meet section 4(c)(5) conditions are not subject to the disposition requirement prescribed in section 4(c)(2); however, such shares would continue to be subject to requirements for disposition as may be prescribed by provisions of any other applicable banking laws or by the appropriate bank supervisory authorities.

Section 4(c)(6) of the act allows a bank holding company to own shares, including those acquired DPC, of any nonbank company that does not exceed 5 percent of the outstanding voting shares of such company. The Board has expressed an opinion (12 C.F.R. 225.101(f)) that any shares acquired DPC under this section, whether by a holding company or a bank subsidiary, are not subject to the disposition requirements of section 4(c)(2) of the act.

Real property is often shown on an entity's books as other real estate (ORE). Possession of ORE usually results from a distressed loan collateralized by a lien on real estate. In addition, in attempting to salvage other types of credit, an entity may have obtained title to real property through process of law or by voluntary deed. Acquisition costs for other real estate acquired for debts previously contracted usually consist of the principal amount that was due on the defaulted loan at the time the entity took possession, unpaid interest, legal fees and other foreclosure costs, accrued and unpaid taxes, and mechanic's liens. Property acquired DPC may be recorded on the company's books by capitalizing the loan amount and acquisition costs. Advances to complete the project can be included in the capitalized investment if the ORE is an unfinished project. The fact that the additional investment is being used to improve the property and make the property more saleable should be evident.

A company owning a DPC asset should maintain records documenting its efforts to dispose

of the asset. Because an ORE asset is normally a nonliquid, nonproductive asset of uncertain value, a company should attempt to dispose of the asset at the earliest date possible. Unless special circumstances are present, a company should sell the ORE asset when a price offer sufficient to cover the acquisition, investment, and carrying costs is obtained.

3030.0.2 INSPECTION OBJECTIVES

1. To determine compliance with applicable laws, rulings, and regulations, and to initiate corrective action when violations appear in these areas.

2. To determine whether policies, practices, and internal controls regarding DPC shares, other assets, or real estate are adequate and to recommend correction when deficiencies are noted.

3. To evaluate the quality of DPC shares, other assets, or real estate and the progress toward their disposition.

4. To determine whether the DPC shares, other assets, or real estate acquired are recorded at fair market value.

3030.0.3 INSPECTION PROCEDURES

1. During the preinspection review, compile a list of shares, other assets, and real estate known to have been acquired DPC by the bank holding company and its nonbank subsidiaries, as well as a list of shares known to have been acquired DPC by the BHC's bank subsidiaries. Information on this list should include—

a. a description of the shares or asset(s);

b. the fair market value of the shares and asset(s), and the method of valuation, if available;

c. the name of the company owning the shares and asset(s); and

d. the date the shares and asset(s) were acquired.

2. If the shares or asset has been held longer than the initial holding period, determine whether the BHC has requested an extension of time.

3. In the Officer's Questionnaire, request a list of DPC shares, other assets, or real estate owned by the holding company and its nonbanking subsidiaries, and a list of DPC shares owned by the holding company's bank subsidiaries, including a detailed description of the shares or asset, the value of the shares or asset on the entity's books, the date the shares or asset was acquired, and plans for disposal of the shares or asset. In addition, a list of DPC shares, other assets, or real estate which has been disposed of since the previous inspection or within the past year should be obtained. Compare these lists with the list compiled during the preinspection review.

4. Review other real estate owned accounts to evaluate—

a. the fair market value of the property (A qualified appraiser should appraise the property at the time of acquisition, and subsequent timely appraisals should be conducted to determine the current fair market value of the property.);

b. the carrying costs of the property; and

c. the company's efforts to dispose of the property (Information on file should include documentation showing a record of offers made by potential buyers and other information reflecting efforts to sell the property (i.e., advertisement brochures)).

5. Determine whether additional advances have been made on an unfinished project and whether evidence supports that the advances are making the property more saleable.

6. Determine whether a first-lien status exists and whether there are any tax liens or other encumbrances against the property.

7. Discuss DPC shares, other assets, or real estate and their values with management who is familiar with the history and current status of the shares or asset and assign classification, if warranted. A substandard classification may be applied when a company is sustaining losses in maintaining the property, and prospects for sale are not evident or encouraging. A company's acquisition of property through foreclosure often indicates a lack of demand and, as time elapses, the value of the real estate may become more questionable if the lack of demand persists. If the carrying amount of the investment exceeds the estimated value of the property, an adequate allowance reserve for any difference should be established and maintained. Property that is in the process of being sold for an amount in excess of the carrying value should not be classified if it appears that ultimate payment will be forthcoming.

8. List shares, other assets, and real estate acquired DPC under ''other assets'' in the inspection report. For significant shares and assets, the examiner may choose to present in the inspection report or in the workpapers, whichever is deemed appropriate, the following information:

a. a brief description sufficient to identify the property, the manner in which the property was acquired, and the reasons for its acquisition

b. the value of the shares or assets on the books of the company, the method used to determine the booked value, and whether it is the fair market value

c. a brief statement as to management's efforts to sell the property, its opinion of the likelihood of sale, and the anticipated sales price

d. a summary of the carrying costs subsequent to assumption and income generated from the property

e. the date when the holding company or its subsidiary must dispose of the property or request an extension to continue to hold the DPC shares or asset

f. the amount classified, if appropriate

g. any apparent discrepancies with rules or regulations

3030.0.4 Laws, Regulations, Interpretations, and Orders

Subject	*Laws* [1]	*Regulations* [2]	*Interpretations* [3]	*Orders*
Transactions not requiring Board approval:				
1. Acquisition of securities by a BHC with majority control	1843(c)(2)	225.12(b)		
2. Acquisition of securities by a BHC with majority control		225.12(c)	4–020	1980 FRB 654
Required disposal by Regulatory Agency	1843(c)(3)			
Section 4(c)(5) and 4(c)(6) shares with respect to Section 4(c)(2)		225.101	4–187	
Delegation of Authority to extend time to dispose of DPC shares and assets		265.2(f)(12)		
Policy statement concerning divestitures by BHCs		225.138		
Disposition of property acquired in satisfaction of debts previously contracted		225.22, 225.140		

1. 12 U.S.C., unless specifically stated otherwise.
2. 12 C.F.R., unless specifically stated otherwise.
3. *Federal Reserve Regulatory Service* reference.

Section 4(c)(4) of the Bank Holding Company Act provides that nonbank shares held or acquired by a bank in good faith in a fiduciary capacity are exempt from the general prohibitions of section 4 of the Act. This exemption is provided to allow banks to carry on their normal fiduciary operations without significant interference and without being subject to the limitations of the Bank Holding Company Act. Without this exemption, a subsidiary bank could act as trustee for up to only 5 percent of a nonbank company's shares as provided by section 4(c)(6) of the Act.

There are certain exceptions which were included within the body of the section 4(c)(4) exemption to prevent utilization of the trust vehicle to circumvent the intent of the Act. The section 4(c)(4) exemption is not applicable when shares acquired are held by a trust which is considered a ''company'' under section 2(b) of the Act. Under section 2(b), a trust is defined as a company if it does not terminate within 25 years, or within 21 years and 10 months after the death of individuals living on the effective date of the trust. Such trusts are generally referred to as perpetual trusts and include employee benefits and charitable trusts which can operate in perpetuity.

Another exception to the exemption implies that no more than 5 percent of the shares of a nonbank company may be held by a subsidiary bank as trustee under a trust established for the benefit of the bank itself, the bank's parent company or any of its subsidiaries, or the shareholders or employees of the bank, the parent company or its subsidiaries as indicated in section 2(g)(2) of the Act. Employee benefit trusts have become a principal source of banks' trust assets. As strictly applied, section 4(c)(4) would limit acquisition of stock of a nonbank company to 5 percent of its shares for employee trust accounts of banks which are subsidiaries of bank holding companies.

3040.0.1 TRANSFER OF SHARES TO A TRUSTEE

Section 2(g)(3) of the Act is tied to section 4(c)(4) by specific reference as an exception to the fiduciary exemption. Section 2(g)(3) provides that shares transferred by a bank holding company to a transferee are deemed to continue to be controlled by the bank holding company if the transferee is indebted to the bank holding company or has one or more officers, directors, trustees or beneficiaries in common with or subject to control by the holding company. However, the Board may determine after opportunity for hearing in such cases that control does not exist.

Relating this to section 4(c)(4), if a bank holding company transfers nonbank shares to a trustee where the trustee has one or more directors in common with the bank holding company, the nonbank shares are deemed to be controlled by the bank holding company until the Board determines otherwise.

3040.0.2 TRUST COMPANY SUBSIDIARIES

Even though section 4(c)(4) refers by its language to shares held or acquired by a *bank* in good faith in a fiduciary capacity, the exemption also applies to shares held or acquired in a fiduciary capacity by a trust company subsidiary of a bank holding company.

3040.0.3 OTHER REPORTING REQUIREMENTS

Holdings in fiduciary capacities of nonbank stock over 5 percent in certain circumstances, may also trigger reporting requirements under the federal securities laws.

3040.0.4 INSPECTION OBJECTIVES

To determine that nonbank shares held by a bank in a fiduciary capacity are in compliance with section 4(c)(4).

3040.0.5 INSPECTION PROCEDURES

Review the holding company's internal reporting procedures to establish that bank trust departments report 5 percent holdings in nonbank companies. In multibank companies, determine that controls are in place to aggregate nonbank shares held by each bank so that if an aggregate of 5 percent is held, it is reported in the Y–6.

3040.0.6 LAWS, REGULATIONS, INTERPRETATIONS, AND ORDERS

Subject	*Laws* [1]	*Regulations* [2]	*Interpretations* [3]	*Orders*
Interests In Nonbanking Organizations		225.12(a) 225.22(c)(3)		

1. 12 U.S.C., unless specifically stated otherwise.
2. 12 C.F.R., unless specifically stated otherwise.
3. Federal Reserve Regulatory Service reference.

Section 4(c)(5) of the Bank Holding Company Act permits (without prior approval) investments by a bank holding company in shares of the kinds and amounts eligible for investment by national banks under the provisions of section 5136 of the Revised Statutes (12 U.S.C. 24(7)).

National banks are prohibited by section 5136 of the Revised Statutes from purchasing and holding shares of any corporation except those corporations whose shares are specifically made eligible by federal statute. This prohibition is made applicable to State member banks by section 9, paragraph 20 of the Federal Reserve Act (12 U.S.C. 335).

In 1968, the Board interpreted section 5136 as permitting a member bank to purchase shares of a corporation engaging in business (at locations the bank is authorized to engage in business) and carrying out functions the bank is empowered to perform directly. Section 5136 is a broad statute with types of permissible activities both explicitly defined and implied indirectly without express definition. Therefore, to limit the need for constant Board interpretation regarding the implied areas of section 5136, the Board curtailed the authority of a bank holding company to acquire shares on the basis of section 4(c)(5) through section 225.22(d) of Regulation Y. As a result, effective June 30, 1971, permissible shares for bank holding company acquisition under section 4(c)(5) are limited to those *explicitly* authorized by any federal statute. Additional reasons for limiting the scope of activities to those explicitly defined by statute, are that section 4(c)(5) acquisitions require neither prior Board approval, nor the opportunity for interested parties to express their views, nor any prior regulatory consideration of anti-trust and related matters.

3050.0.1 COMPANIES IN WHICH BHC'S MAY INVEST

The following is a list of permissible companies expressly authorized by federal statute. The list includes the companies most frequently encountered.

1. Small business investment companies ("SBICs").
2. Agriculture credit companies.
3. Edge and agreement corporations.
4. Bank premises companies (usually exempt under section 4(c)(1)(A)).
5. Bank service corporations (usually exempt under section 4(c)(1)(C)).
6. Safe deposit companies.
7. Obligations of student loan marketing associations.
8. State housing corporations.

3050.0.2 LIMITATIONS

On most 5136 authorizations, share investments are limited in some form, usually based on a percentage of the bank's capital and surplus. Under section 4(c)(5), a holding company's investment in such shares is also limited by amount and type to those permitted for a national bank to prevent avoidance of these limitations by a bank holding company.

3050.0.3 INSPECTION OBJECTIVES

1. To determine the permissibility of each activity encountered during the inspection which claims a section 4(c)(5) exemption.
2. To determine if the operations and financing of the section 4(c)(5) activity is not to the detriment of the bank(s).

3050.0.4 INSPECTION PROCEDURES

1. Review compliance with section 5136 of the Revised Statutes to determine if the activity is expressly permitted by any federal statute.
2. Determine the financial condition of the activity and its impact on the bank affiliate.

3050.0.5 LAWS, REGULATIONS, INTERPRETATIONS, AND ORDERS

Subject	*Laws* [1]	*Regulations* [2]	*Interpretations* [3]	*Orders*
Permissible investments for a national bank	(Section 5136 of the Revised Statutes)			
Investment in bank premise corporation	371d	250.200	4–185	
Investment in bank service corporation	1861–65	250.301	1–329	
Investment in small business investment corporation (SBIC)	15 USC 682b	225.107 225.111 225.112	4–173 4–175 4–174	
Operating subsidiaries/ loan production offices		250.141	3–415.4	
Section 23A Section 23B	371c 371c	250.240	3–1133 1–206.1	
Mortgage company		225.122	4–196	

1. 12 U.S.C., unless specifically stated otherwise.
2. 12 C.F.R., unless specifically stated otherwise.
3. Federal Reserve Regulatory Service reference.

3060.0.1 SECTION 4(c)(6)

This section provides an exemption for ownership of shares of any nonbank company that do not exceed 5 percent of the outstanding voting shares of such company. The exemption is designed to permit diversification of investments by a bank holding company and its subsidiaries which do not result in control of a nonbanking organization. The Board has indicated through an interpretation of 12 U.S.C. 225.101, that in its opinion, the 5 percent limitation applies to the aggregate amount of voting stock in a particular nonbank company held by the entire bank holding company organization including the parent company and all of its direct and indirect bank and nonbank subsidiaries. This is to prevent a holding company from acquiring a controlling interest in a nonbank company through ownership of small blocks of stock by numerous subsidiaries in circumvention of the provisions of section 4 of the BHC Act.

3060.0.1.1 D.P.C. Shares

The same interpretation (12 C.F.R. 225.101) also addresses the question of the applicability of section 4(c)(6) to nonbank shares acquired in satisfaction of debts previously contracted (D.P.C.) by a subsidiary bank, any nonbank subsidiaries, or the parent company. In this instance, the Board expressed the opinion that the 5 percent exemption provided by section 4(c)(6) covers any nonbank shares, including those acquired D.P.C. Consequently, shares which meet such conditions are not subject to the disposition requirements of section 4(c)(2) of the Act. It is important to remember that the exemption provided by section 4(c)(6) applies only to shares of any nonbank company. Acquisitions of any bank shares are subject to the provisions contained in section 3(a) of the Act.

Although the 5 percent limitation of this section applies, by its language, to ''voting shares'' rather than ''any class of voting shares'' as used elsewhere in the Act, the Board has indicated in 12 C.F.R. 225.137 that it applies to ''any class of voting shares'' rather than to the aggregate of all classes of voting shares held. Thus section 4(c)(6) is not available to a group of BHCs each owning a ''class of voting securities'' even if each BHC owns less than 5 percent of all shares outstanding. Further, section 4(c)(6) must be viewed as permitting ownership of 5 percent of a company's voting stock only when that ownership does not constitute ''control'' as otherwise defined in section 2 of the Act.

Note that section 4 prohibits engaging in nonbank activities other than those permitted by section 4(c)(8). Thus, if a BHC may be deemed to be ''engaging in an activity'' through the medium of a company in which it owns less than 5 percent of the voting stock it may nevertheless require Board approval, despite the section 4(c)(6) exemption.

3060.0.1.2 Acquisition of Nonbank Interests—Royalties as Compensation

A bank holding company requested an opinion on the permissibility of its subsidiary's receiving limited overriding royalty interests in oil, gas, and other hydrocarbon leasehold interests as partial compensation for investment advisory services in connection with those properties. The bank holding company was not acquiring more than 5 percent interest in any project. The subsidiary was to place the assigned royalties in a compensation plan for assignment to certain professional employees. Neither the subsidiary nor any affiliate were to acquire, hold, locate, sponsor, develop, organize, or manage any other energy property investment or in any other manner control the investment. The subsidiary was to hold interest in energy properties only if the interest had not yet been reassigned to an employee, or if an employee terminates service with the subsidiary and is required to reassign his or her energy properties to the subsidiary. The bank holding company's proposal was consistent with section 4(c)(6) of the Bank Holding Company Act, which exempts passive investments of 5 percent or less from the prohibitions of section 4 of the Bank Holding Company Act.

3060.0.2 SECTION 4(c)(7)

This section provides bank holding companies the opportunity to own, directly or indirectly, shares of an investment company (any amount up to 100 percent of outstanding shares) provided that each of the following conditions is met:

1. The investment company is not itself a bank holding company;
2. The investment company is not engaged in

any business other than investing in securities; and

3. Securities in which the investment company invests do not include more than 5 percent of the outstanding voting securities of any company.

4. As in section 4(c)(6), the 5 percent limitation applies, by its language, to ''voting shares'' rather than ''any class of voting shares,'' as used elsewhere in the Act. However, the criterion applies to ''any class of voting shares'' for purposes of this section.

The 5 percent restriction does not prevent an investment company from having direct or indirect subsidiaries of its own, provided that ownership of such subsidiaries is permitted under another provision of the Act. Rather, the limitation is intended to apply only to securities purchased in the ordinary course of investing by the investment company.

The legislative history of this provision of the Act does not provide a clear indication as to the type of institutions encompassed under the term ''investment company'' as used in this section. It appears, however, that any company primarily engaged in the purchasing and ownership of securities may be regarded as an investment company for purposes of this section. Section 4(c)(7) can be viewed, more or less, as an extension of section 4(c)(6) which permits a bank holding company to directly or indirectly through subsidiaries own up to 5 percent of the voting stock of any nonbank company. In fact, until the Amendments of 1966, the Bank Holding Company Act incorporated both section 4(c)(6) and section 4(c)(7) under one section. From a practical standpoint, the parent company is allowed, under section 4(c)(6), to directly engage in the same activities as an investment company. Accordingly, most holding companies conduct these activities through the parent company, rather than through an investment company subsidiary. Such an arrangement prevents duplicate payment of certain taxes and provides more flexibility for utilizing funds in other areas of the organization.

3060.0.3 INSPECTION OBJECTIVES

3060.0.3.1 Section 4(c)(6)

1. To determine that the investments held pursuant to section 4(c)(6) comply with the Act and 12 C.F.R. 225.101 and 225.137.

2. To determine that no more than 5 percent of the voting shares of any nonbank company (other than those owned pursuant to other provisions of the Act) is held by the bank holding company and its subsidiaries.

3060.0.3.2 Section 4(c)(7)

1. To determine the overall quality of the investments held.

2. To determine the financial impact of the ownership of such shares upon the bank holding company and its subsidiaries.

3. To determine if policies, practices and procedures regarding investments are adequate.

4. To suggest corrective action where necessary in the areas of policies, procedures, or laws and regulations.

3060.0.4 INSPECTION PROCEDURES

3060.0.4.1 Section 4(c)(6)

1. Review investments held to determine that the BHC has a total interest of no more than 5 percent.

2. Determine that 5 percent does not constitute control.

3. Determine that the BHC is not ''engaged'' in any nonbank activity through its 5 percent ownership.

3060.0.4.2 Section 4(c)(7)

1. Where section 4(c)(7) applies, compare the investment company's general ledgers with statements prepared for the latest FR Y–6.

2. Obtain schedules of investments in voting shares of any companies. Review quality of such shares (utilizing rating service publications, etc.) and check for ownership interests exceeding 5 percent.

3. Review policies (written or oral) regarding purchase and sale of stocks.

4. Obtain and evaluate documentation relating to credit review for securities held. Determine adequacy of procedures to maintain credit updates.

5. Compare carrying value of stocks to current market value to determine market depreciation, if any and determine adequacy of any established reserves.

6. Perform verification procedures, including physical review of stock held in safekeeping, where practical.

7. Determine that purchases and sales of stocks are appropriately approved by directors or designated officers.

8. Review minutes of the board of directors meetings (where an investment company subsidiary is involved).

3060.0.5 LAWS, REGULATIONS, INTERPRETATIONS, AND ORDERS

Subject	*Laws* [1]	*Regulations* [2]	*Interpretations* [3]	*Orders*
4(c)(6) Applicability to shares acquired D.P.C.		225.101	4–187	
Aggregating shares owned by subsidiaries		225.101	4–187	
Five percent limit on ''any class of voting securities''		225.137	4–189	
Control with less than 5 percent		225.137	4–189	
4(c)(7) Indirect ownership of shares of investment company		225.102	4–188	

1. 12 U.S.C., unless specifically stated otherwise.
2. 12 C.F.R., unless specifically stated otherwise.
3. Federal Reserve Regulatory Service reference.